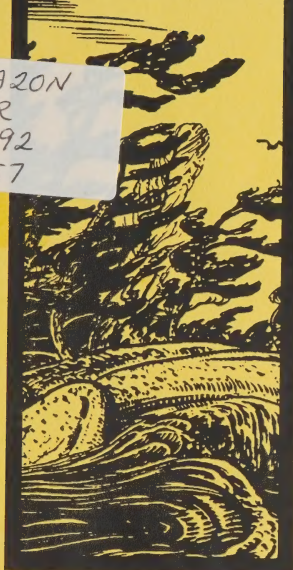


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ONTARIO FISCAL OUTLOOK

Paul Lacombe
Minister of Finance
January 1992



ONTARIO FISCAL OUTLOOK

**Floyd Laughren
Treasurer of Ontario
November 1992**

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ONTARIO FISCAL OUTLOOK

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Introduction

This Fiscal Outlook provides an overview of the economic and financial circumstances that the Government must consider as we begin to prepare the 1993 Ontario Budget.

Since the beginning of the recession in late 1989, Ontarians have faced the most severe economic situation since the 1930s. While the worst may hopefully be behind us, the road to recovery will be a difficult one.

We are not alone. Across the industrialized world, economic activity has been slowed, unemployment has been high, and growth is sluggish. Government revenues are weak, and the need to help those who have been hurt by the recession has increased.

The Government has introduced a long-term plan to bring Ontario's operating budget into balance by 1997. This plan includes financing for investments that will help workers and employers prepare for the economy of the future. It includes funding for the public services that Ontarians value and that make this a good place to live and do business.

We are persevering to implement this plan. But the problems we face have become more serious than we knew last spring. The economy is recovering more slowly than we and others had forecast. Our revenues have been slow to recover, too.

Economic recovery is essential, but it will not solve our financial problems. Simply put, even with a more robust recovery, our government revenues will not improve to a level which will allow us to fund public services as we have in the past. This means that we have to redouble our efforts to restructure public services and to make them more affordable. We have to deliver services more efficiently, focus on the essentials, and at the same time treat people fairly who are affected by change.

As we prepare the 1993 Ontario Budget, the Government must make some tough decisions. We think it is important to make available to the public the facts as we know them about our province's economic situation and how it affects the Government's finances.

Slow Growth in Government Revenues

The depth of the recession, and the slow pace of economic recovery, have had a serious effect on the revenues available to the Government.

Based on our outlook for economic growth, we expect that -- in the absence of any further policy changes -- Government revenues for 1993-94 would total \$43.8 billion. This figure is \$4.2 billion lower than our plan as set out in the 1992 Budget.

Our revenue outlook for 1993-94 assumes that revenues for the current year will hold at their expected level. There is still uncertainty for the 1992-93 forecast because some key information is not yet available, including sales tax revenues during the critical Christmas season, final tax payments by corporations in February and March 1993, and any further adjustments to personal income tax revenues when final information becomes available in February. Any revisions to the 1992-93 outlook could also change the 1993-94 outlook.

Taxes account for about three-quarters of the Government's revenues, and they have been significantly affected by the slow economy. Consumers who trim their spending pay less Retail Sales Tax. Workers who are unemployed pay less Personal Income Tax. Corporations with lower profits pay less Corporations Tax, and they can carry forward their losses to reduce their taxes in future years.

The overall effect on our financial circumstances has been considerable. Tax revenues fell by almost \$3 billion in 1991-92 from the previous year. While they have begun to recover, we already know that in 1992-93 -- due to lower-than-expected economic growth -- tax revenues will be \$530 million less than we had hoped last spring. This loss will affect next year's revenues, too, since it lowers the base from which revenues will grow.

For 1993-94, the outlook is that -- without any further changes in tax policy -- tax revenues will still be lower than they were three years ago.

- Personal Income Tax revenues -- which account for 31 per cent of Ontario's total revenues -- will be \$835 million lower next year than they were in 1990-91.
- Revenues from the Retail Sales Tax -- which account for 17 per cent of our revenues -- are expected to be \$175 million lower next year than in 1990-91, the year the federal GST was introduced.
- Revenues from the Corporations Tax -- which account for 7 per cent of our revenues -- are expected to be \$135 million lower next year than in 1990-91.

The slow recovery of our revenues poses a difficult challenge as we prepare for next year's Budget.

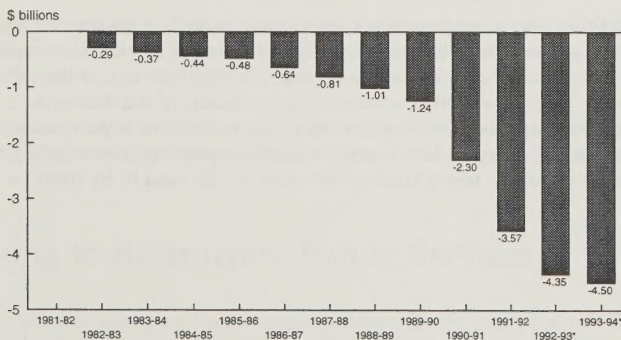
Restrictions on Federal Transfers for Health, Education and Social Services

It is important to understand how Ontario's revenues are being affected by decisions taken by the federal government.

At the same time that the economy has been weakened by the recession, the federal government has dramatically cut its share of support for Ontario's health, education and social programs. Until 1990, the federal government paid for half of the costs of social assistance in Ontario; in the coming year the federal contribution will cover less than 29 per cent. At the same time, Ontario residents are continuing to help pay for federal financing of 50 per cent of social assistance costs in most other provinces. The federal share of health and post-secondary education costs in Ontario has fallen, too, from a high of 52 per cent in 1979-80 to 31 per cent in the coming year.

The consequences have been severe. If the federal government had honoured the original terms of its legislation covering these programs, the Ontario deficit would have been \$4.4 billion lower in 1992-93, and \$4.5 billion lower in 1993-94. *The total revenues from all of the tax changes introduced since this Government came to office are not enough to replace the extra federal off-loading that has taken place during this period.*

**Ontario Revenue Losses Due to Limits on Federal Payments
for Health, Post-secondary Education and Social Assistance**



* Projected

Note: Cumulative losses 82-83 to 93-94: \$20 billion.

Sources: Finance Canada, Ontario Ministry of Treasury and Economics.

By walking away from its obligations, the federal government has passed to Ontario more of the responsibility for maintaining our health care system, our colleges and universities, and our support services for families in need. There is little that Ontario can do in the short run

about these federal policies. But they are a reality for us, and they have a real effect on our ability to meet people's needs while managing our finances responsibly.

Achieving Our Long-term Financial Plan

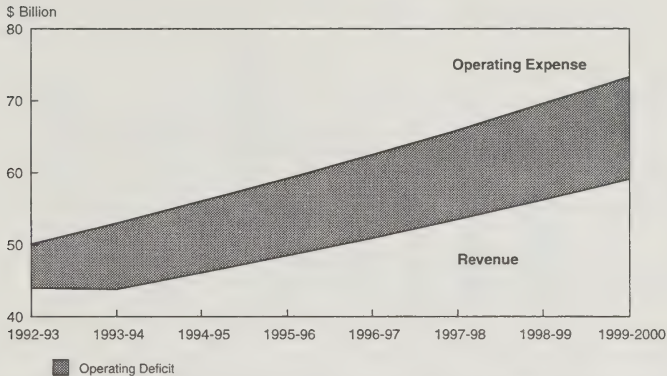
In last spring's Budget we published a plan to reduce our operating deficit in 1993-94 as part of a longer-term plan to balance the operating budget by 1997. While recognizing the significant and unexpected shortfall in our revenue base, the Government is still striving to reduce our 1993-94 deficit from its 1992-93 level.

It is important to understand why controlling the deficit is a priority. Our economy can support the debt load we are now carrying. Our debt is lower, as a share of the economy, than that of most other provinces, and certainly lower than the federal government's. Our credit rating compares well with that of other provinces and with most of the major industrial states in the U.S.

But we cannot afford to allow our debt load to grow any faster. This year we will spend 12 cents of every dollar we take in on debt interest. If we did not continue to manage carefully, it would be easy for this figure to exceed 20 cents within three or four years. Recent instability in financial markets increases the risk that these costs could move higher. Like the federal government -- which now spends more than 30 cents out of every revenue dollar on debt interest -- Ontario would face a debt trap that would greatly reduce our flexibility to address real needs or to invest in economic renewal.

We cannot avoid this debt trap by waiting for economic growth to restore our revenues. The revenue downturn during the recession, coupled with the need to assist those who were most hurt by the recession, has given us a long-term deficit problem. As the following chart shows, even under highly favourable assumptions -- a decade of uninterrupted economic growth, low inflation, and low spending growth -- we would have unacceptably high deficits long into the future. Every year, debt interest and other operating costs would grow more quickly than revenues, and a larger share of revenues would need to be spent on debt interest.

Economic Recovery By Itself Would Not Solve Our Financial Problems



To avoid this unacceptable scenario will require very tough decisions.

- We have taken steps early to keep our operating expenditures on target for 1993-94. While some difficult choices face us over the coming weeks, we are on track to meet our operating expenditure target of \$53.0 billion for next year.
- But our revenues have not yet recovered from the recession. As shown above, based on policy decisions that have been taken to date, the outlook is that our total revenues next year will be \$4.2 billion less than planned.
- The implication of this is clear: *between now and next spring's Budget, we must make additional revenue and expenditure decisions in order to close the gap caused by this revenue shortfall.*

Continuing to Restructure Public Services

Ontario is not alone in facing a tough financial situation for the coming year. The federal government and other provinces are also reporting lower-than-expected revenues. So are many of the large industrial states in the United States, such as Ohio, New Jersey, Pennsylvania and California.

How we deal with this reality is an important test of our values.

When this Government came to office two years ago, we knew that a thoughtless downsizing of the major public services that are important to the people of Ontario would be an

unacceptable solution. To reduce the support that is available to unemployed workers and their families at a time of severe need, or to undercut the fundamental principles of the health care system that we treasure, might reduce our financial problem in the short run -- but at a cost of dismantling services that are a hallmark of our society.

At the same time, we cannot simply ignore our financial problem. In 1992-93 Ontario's operating deficit is projected to be \$6.2 billion. In other words, we will be borrowing more than \$6 billion this year simply to top up our contribution to the ongoing costs of running schools, hospitals, universities, social programs, the courts and other government services. While borrowing during a recession is justified, every householder knows that you cannot borrow money year in and year out simply to pay for everyday expenses.

The approach that the Ontario Government has adopted deals with Ontario's priorities today while at the same time preparing us for the demands of the future economy.

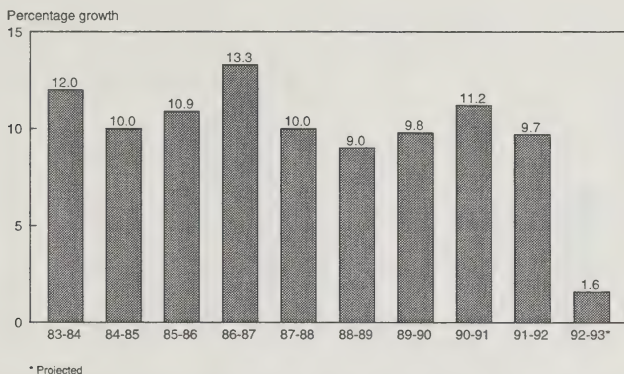
- The Government is re-thinking the way we provide public services. Around the world, large organizations are learning to provide high-quality goods and services without high costs -- by organizing themselves more effectively, by improving productivity, and by taking a hard look at their priorities. Some of the same principles must be applied to organizations that provide public services. At a time when revenues are limited, the only way to protect the public services that we value is to take a fresh look at how we are delivering them.
- And while services are being restructured, the Government is also taking a hard look at our internal operating costs, as part of the overall plan to keep the deficit in check.

Restructuring Public Services

We began to restructure some important services in our Budget last spring. We are on track to produce some significant successes:

- Spending on health care -- which accounts for one-third of our total budget -- is expected to grow by only 1.6 per cent this year. This is far below the 11 per cent average increase over the past decade. By reforming the health care system, we are ensuring that we can continue to enjoy its benefits at an affordable cost in future years. And we are maintaining one of Ontario's strongest advantages as a location for new investments.

Growth in Ministry of Health Spending



- Tax grants for Ontario's seniors have been replaced with tax credits that provide greater benefits to low-income seniors while at the same time reducing the overall cost to the public.
- After three years of significant increases due to the recession, spending growth on social assistance has begun to taper off. This reflects administrative improvements and assistance to clients in gaining access to other sources of income, as well as improvement in the economy.

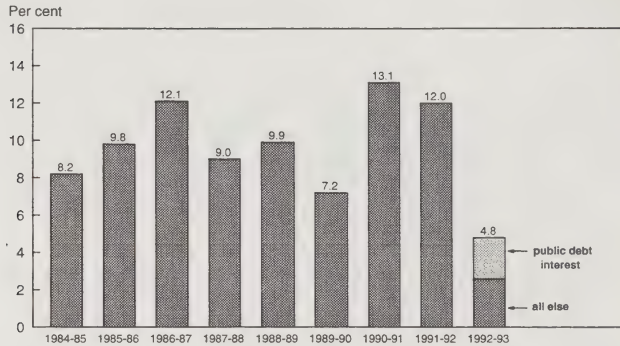
Through these and other measures, we are working to provide taxpayers with better value for their tax dollars.

Managing Better and Keeping the Deficit in Check

At the same time that we have been restructuring public services, we have made significant accomplishments in managing our internal spending and keeping the deficit in check:

- By aggressively reviewing our spending, we have reduced spending growth this year by \$4 for every \$1 in new taxes.
- Excluding debt interest, our operating spending is growing by only 2.8 per cent this year.

Growth In Operating Expenditures



- Fifteen ministries will actually spend less this year than last.
- We have cut ministry budgets by 15 per cent for travel, supplies, consulting and other overhead.
- We have frozen the salaries of Cabinet ministers, MPPs and senior managers this year.
- Our two-year program to reduce the size of the public service by 2,500 positions is on track.

Our challenge for the coming year is to build on these actions.

Tough Choices for the Coming Year

Even with all the steps we have taken so far, we face tough choices for the coming year. We need to ensure that there is money available to invest in economic renewal. We need to protect important public services. And we need to keep our finances under control.

To achieve our goals, we are continuing with the government-wide review of programs that was begun last year, and we are expanding our efforts. Every minister in the Cabinet is involved in these reviews. The objective of these reviews is to preserve the quality of the public services that we value – by organizing ourselves more effectively, by improving productivity, and by taking a hard look at our priorities. Restructuring in the public sector must be a continual process of changing and adapting to ensure that government is efficient, effective and affordable.

The results of some of these reviews will be made known over the coming months, leading up to the 1993 Budget. We are determined to take every reasonable step to renew the economy, preserve public services and keep a tight rein on our finances.

The Road to Economic Recovery

Last spring, the Ontario government announced three priorities to meet Ontarians' needs during the 1990s:

- To support investments that will help prepare our economy for the future
- To maintain the public services such as health care that are important to us, while making them more affordable so we can continue to enjoy them in the future
- To keep the deficit in check, so that rising debt interest charges do not eat into the money that is needed for economic renewal and public services.

We need to pursue all of these priorities, because they are closely related. We need to attract new industries if we want to improve our standard of living and continue to enjoy high-quality services. We need to protect and improve services like health care and education if we want to keep our advantages as a good place to live and to invest. And we need to keep our deficit under control if we want to avoid a rising tide of interest charges that will otherwise crowd out our funding for economic renewal and public services.

Our 1993 Budget will continue with this plan. At the same time, it must reflect the fact that the economy is turning around more slowly than we had hoped.

Ontario's economy is emerging from its most severe recession since the 1930s. The economy has been growing since the spring of 1991. Yet the after-effects of the recession are still evident across the province.

The number of unemployed workers has more than doubled since the recession began, to 600,000. In many cases, their old jobs have been lost forever. One-fifth of our children live in families that are relying on social assistance to meet their needs.

Many of the conditions that normally precede an economic recovery are in place. Interest rates have fallen. Housing has become more affordable. Inventories are low. Consumers and businesses are paying down the debts they built up in the 1980s. Exports have risen, housing starts are up, and consumer spending has shown strength in recent months. Industrial employment overall has stabilized, and callbacks in some industries have begun.

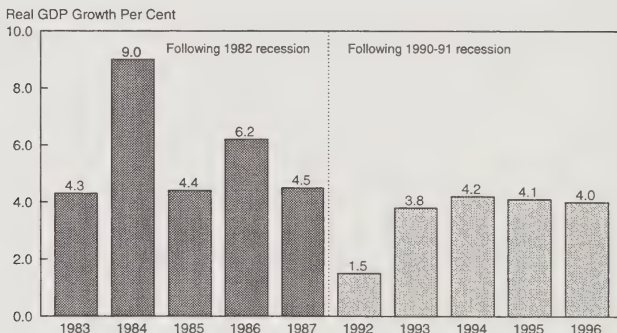
Despite these encouraging signs, job creation across the province remains weak.

That's because, even as the recovery is slowly beginning, the structure of our economy is changing. Many of our traditional industries are reducing employment to remain competitive in the face of stronger global competition. Prices remain depressed for many resource products that have been important to our economy. Even workers continuing in their same jobs will need new skills.

In October we published the Ontario Economic Outlook for the next four years. We expect the pace of economic recovery to improve somewhat in 1993, with real GDP growth of 3.8 per cent.

This outlook for growth is encouraging, and it is comparable to forecasts published by other economists outside the Government. Yet this recovery is far slower than the recovery from the last recession. In the two years after the 1981-82 recession, the economy grew by more than 13 per cent in real terms. The comparable figure for this recovery is expected to be 5.4 per cent. No one can be under the illusion that normal times have returned.

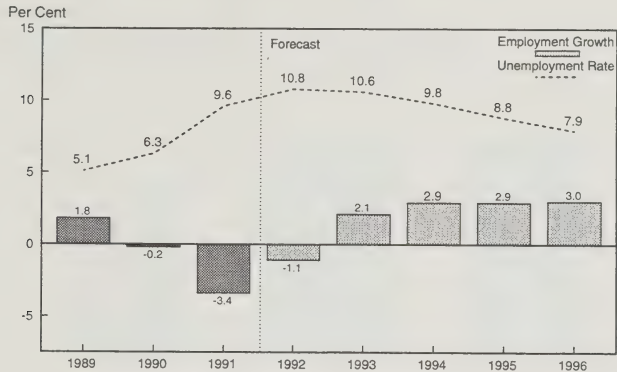
Economy Recovering More Slowly Than In 1980s



Sources: Statistics Canada and Ontario Ministry of Treasury and Economics

And with the structural changes in our economy, job creation will be painfully slow. Based on our Economic Outlook, we expect the unemployment rate to fall slightly to 10.6 per cent in 1993. By the end of 1996 – five years after the end of the recession – our projections show that the unemployment rate will still be as high as 7.9 per cent. At a comparable point following the last recession, the unemployment rate had fallen to 6.1 per cent.

Unemployment to Decline Slowly



Sources: Statistics Canada and Ontario Ministry of Treasury and Economics

We expect that low inflation will continue. Last January we expected inflation for 1992 to be 2.3 per cent; in reality, it has been even lower, at about 1.4 per cent. At present we expect the CPI inflation rate for 1993 to be 2.0 per cent, which again is significantly lower than our forecast last January.

In sum, the economy of the 1970s and 1980s has changed. This makes it all the more important that adequate funds continue to be available in the Budget for economic renewal in Ontario.

Investing in Economic Renewal

The Ontario Government supports economic restructuring that improves our standard of living and that allows us to maintain the public services that we value. That is why the first of the three priorities in our Budget plan is to support investments that will help prepare our economy for the future.

Many of the most important economic levers are in the hands of the federal government -- for example, interest rates, the value of the dollar, and free trade agreements. We are doing what we can to support jobs in the short term. But we are doing so in a way that prepares the economy for higher productivity growth in the longer term. We are investing in training and capital infrastructure, and we are supporting private sector investments. We are creating the conditions for productivity improvements by promoting fairer workplaces and greater cooperation between employers and workers.

Despite the slow economy, the first fruits of some of these initiatives are starting to appear:

- **jobsOntarioTraining** is helping unemployed workers to retrain and to prepare for jobs in private firms -- as part of a strategy that will assist 100,000 unemployed workers over the next three years. Our total budget for training this year has been increased by 24 per cent.
- Through **jobsOntarioCapital**, we have already committed over \$370 million to strategic capital projects. Along with our base capital, these projects will support over 70,000 direct and indirect jobs by the end of this fiscal year.
- Through **jobsOntarioYouth**, we provided 9,000 young people with job opportunities and work experience this past summer.
- Our tax reforms are providing incentives for private investment in manufacturing, resource industries, small businesses, and research and development.
- We have established the \$150 million Sector Partnership Fund to support Ontario businesses in critical economic sectors to cooperate in improving productivity and competing in international markets.
- We have renewed our financial support for Ontario's seven Centres of Excellence, providing \$216 million over the next 5 years to promote research and development of the highest calibre while building links between Ontario's universities and businesses.

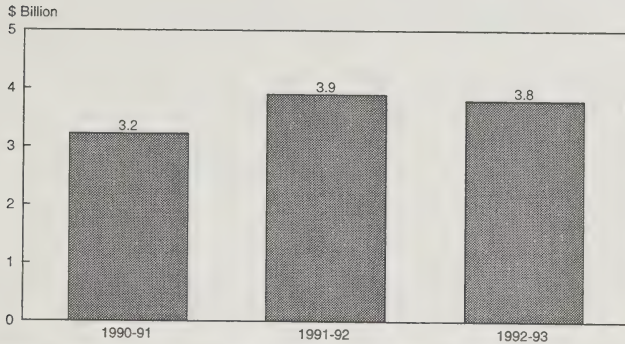
As we plan our Budget, we intend to make sure that adequate funds continue to be available for economic renewal priorities. We know that many of our traditional industries are reducing employment. We need to be sure that Ontario is able to attract the industries of the future.

Global investors will set up new factories and invest in state-of-the-art equipment where there are excellent transportation and communications facilities and well-trained workers. If we neglect to make these public investments that support Ontario's quality of life, the industries of the future will go elsewhere.

A fundamental part of our economic strategy is investing in capital infrastructure -- in transportation networks, water and sewer facilities, science and technology facilities, and telecommunications systems to meet our future needs.

Ontario's infrastructure already compares well with that of most industrial jurisdictions. Over the past two years, the Government has increased our capital budget substantially.

Capital Investments 1990-91 to 1992-93



To ensure that we get maximum returns from our capital investments, the Government initiated a more strategic approach to capital planning in the 1992 Budget. Through **jobsOntarioCapital**, we are facilitating economic recovery and helping to manage and shape economic growth.

In its first year, **jobsOntarioCapital** is already making investments to support the transition to a high value-added economy.

- A new Centre for Advanced Process Technology is being built at Lambton College in Sarnia.
- Improvements are being made to Brock University's mathematics and computer science facilities in St. Catharines.
- A new Skills Training Centre is being developed at Durham College in Whitby.
- Funding has been committed to help create the Design Exchange in Toronto, which will encourage the effective use of design in products and services produced in Ontario and across Canada.
- More than 7,000 social housing units across the province are being fitted with energy-efficient heating systems, creating opportunities to demonstrate new energy-efficient technologies.

- Transportation bottlenecks are being addressed through projects such as the Southeast Bypass in Sudbury.

To ensure that we are able to address strategic priorities, the Government will be taking a new approach to financing capital in the coming fiscal year. We will be establishing capital corporations in fields where major future investments are planned, with the responsibility of funding capital projects through new arrangements such as beneficiary-pay, full-cost pricing, and partnerships with other agencies in the public and private sectors.

This approach reflects the commitment we made in last spring's Budget to explore innovative ways of financing capital and to ensure that the long-term nature of these investments is more clearly recognized, as is the case in other provinces.

These arrangements will help to direct our capital resources in ways which best support economic renewal. They will improve our ability to manage our investments, and they will ensure that our capital needs are met without placing an excessive burden on the taxpayer.

Conclusion

The purpose of this Fiscal Outlook is to provide information about the province's economic and financial circumstances and to encourage informed public debate about the decisions we are facing.

We face tough challenges. We want to encourage changes in the economy that will improve our standard of living. We have to make the investments that are essential to renew our economy. We have to preserve important public services by making them more affordable. And we have to keep our deficit under control.

Over the past year we have made progress on all of these challenges. But we need to do much more over the coming months.

We want to hear your views on how we can best meet Ontario's priorities. If you wish to send a letter or make a written submission relating to the 1993 Budget, please do so by early March, addressing it to:

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